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281526Z Jul 03

UNCLAS SECTION 01 OF 02 ANKARA 004770

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SENSITIVE

STATE FOR E, EB/IFD AND EUR/SE  
TREASURY FOR OASIA - MILLS AND LEICHTER  
NSC FOR BRYZA  
USDOC FOR 4212/ITA/MAC/OEURA/DDEFALCO  
USDA FOR FAS FOR EC AND CCC/FSA

E.O. 12958: N/A

TAGS: EFIN ECON PGOV TU

SUBJECT: TURKS SIGN LOI; PROBLEMS WITH TAKEOVER OF  
UZAN-OWNED BANK

REF: A. (A) ANKARA 4666  
B. (B) ANKARA 4386

¶1. (SBU) Summary: Turkish authorities signed the Letter of Intent (LOI) late July 25, paving the way for the IMF Board to complete the 5th Review as early as August 1. Agreement on the LOI came after GOT officials agreed to seek Parliamentary approval of revised motor vehicle tax legislation this week. Parliament is scheduled to consider this legislation, along with the last pending bill on social security institutions, on July 29. Meanwhile, bank regulatory authorities have uncovered what they believe is systemic double-accounting at the Uzan-owned Imar Bank. Experts are still poring through records, but say the bank's deposit liabilities are several times greater than the \$800 million Imar Bank officially reported (\$5 billion, per the press). Some portion of the larger amount consists of fraudulent accounts or offshore accounts that were transferred onshore during or after regulators took over the bank, but authorities believe the GOT will have to assume liability for significantly more than the \$800 million originally reported. Bank regulators have referred the case for criminal investigation, but are concerned that the problems surrounding the takeover could undermine their credibility and possibly affect public confidence in the banking sector. End Summary.

¶2. (SBU) IMF ResRep reported to us late July 25 that State Minister Babacan and Central Bank Governor Serdengeceti had signed a Letter of Intent (LOI), paving the way for an IMF Board review as early as August 1. The signing took place after a frantic, 24-hour effort to fill the budget hole created by the Constitutional Court's July 24 annulment of a motor vehicle surtax (ref A). According to ResRep and Finance Ministry officials, GOT authorities agreed to resubmit the motor vehicle surtax legislation, slightly revised to address the court's concerns, to Parliament on July 28-29. Parliament is expected to consider this legislation, along with the last remaining social security bill to strengthen the social security institutions, on July 29. IMF and World Bank officials also confirmed to us that the GOT had consulted with them in preparing amendments to the Public Procurement Law, and they were satisfied with the results.

¶3. (SBU) Banking Regulation and Supervision Agency (BRSA) Vice President Ercan Turkan (strictly protect) told us July 28 that the BRSA's takeover of Imar Bank, owned by the notorious Uzan family, had turned into a "huge mess." Turkan confirmed earlier BRSA statements (ref B) that, unlike in previous cases, regulators had decided to liquidate the bank and take responsibility only for deposit liabilities. According to official Imar Bank reports to the BRSA, those deposit liabilities totaled \$800 million. However, the BRSA has subsequently gained partial access to Imar Bank records -- though only with great difficulty and after much delay -- and has learned that deposit liabilities are significantly higher.

¶4. (SBU) Ercan explained that auditors and experts have uncovered what they believe is systemic double-accounting through which the bank appears to have hidden hundreds of millions, if not billions, of dollars in deposits. Initial indications are that total deposit liabilities are in the billions (Ercan did not confirm press reports that the amount is \$5 billion, but other BRSA officials have said total liabilities are "several times greater" than the \$800 million officially reported). Some amount of the difference appears

to consist of deposits that were legitimately made but not reported to BRSA (or the Finance Ministry or Central Bank). Another part appears to be fraudulent accounts and offshore accounts transferred onshore just before, during, and immediately after the bank's takeover. Some of the hidden accounts are old, while others appeared on July 3 (the date of the management takeover) or even later. BRSA auditors are working day and night to go through the accounts to try to separate and define them. Ercan suggested that the BRSA would have to take responsibility for the "legitimately-made" deposits, or risk undermining public confidence in its deposit guarantee, and agreed that the total amount of liabilities the agency would have to take on could be "in the billions of dollars" (though certainly less than the \$5 billion headline figure). The BRSA will not cover fraudulent accounts or offshore accounts transferred onshore.

15. (SBU) Ercan said that the bank owners appear to be guilty of fraud, tax evasion, and violation of banking laws as well as Central Bank regulations (governing reserve requirements). BRSA has already frozen the Uzan's assets in Turkey, while also referring the case to the police and Interior Ministry for possible criminal prosecution. Bank regulators will also try to liquidate the bank's assets, which consist mostly of lending to the Uzan Group companies. Given that this appears to have been a "well organized crime" and that the Uzan Group has top-notch lawyers, BRSA is seeking the help of Interior Ministry and other government legal experts to go after the assets. Ercan acknowledged, however, that this will be a long process. Regulators also have seized management control of Adabank, the Uzan family's second, smaller bank. (Note: The Uzan's had hoped to cement their purchase of state-owned Petkim via a letter of credit from Adabank, which now seems unlikely, to say the least.  
End note)

16. (SBU) The BRSA's immediate concern, in addition to determining the precise amount of deposit liabilities it needs to cover, is to ensure the problems surrounding the handling of Imar Bank do not undermine public confidence in the agency or the banking system. Ercan said that the Uzans are arguing publicly that the BRSA, together with independent auditors, had conducted a three-stage audit of Imar Bank in 2002 and pronounced it solvent and healthy (after a \$340 million capital injection from the Group). Moreover, they say, the Bank has regularly reported its deposit liabilities to the BRSA, so how can it now say it is surprised by the amount? Ercan admitted there is a problem, as the BRSA did pronounce Imar Bank fit in 2002. The explanation, he said, is that -- to find this kind of intentional, well organized fraud -- BRSA auditors would have to have had on-site access to all of Imar Bank's 169 branches. However, with only 80 auditors on its staff, there was no way it could do this. Ercan added that the Uzan's second claim -- that they have reported the full amount of Imar Bank deposits to BRSA all along -- is a flat-out lie. Still, if depositors begin to question the BRSA's competence or honesty, or to wonder what other hidden problems plague the banking system, there could be a decline in confidence and possibly even a run on some small banks. Ercan hastened to add that, so far, BRSA has seen no evidence of such a bank run.

17. (SBU) IMF ResRep told us late today that he would meet with BRSA staff July 29 to discuss the Imar Bank case and next steps. He noted that, at this point, no one knows how much of the hidden deposits actually will end up in the government's hands. Whatever the size of the problem, Fund staff will advise BRSA to transfer legitimate Imar Bank deposits to another, sound bank, and to have Treasury issue bonds to the bank equal to the new liabilities. Such an approach minimizes the fiscal and monetary impact of the problem, though it does add to the Treasury's net liabilities and budgetary expenditures, in the form of increased interest payments. He agreed that the question of how the BRSA's three-stage audit process in 2002 could have missed this enormous financial hole is extremely serious, and one the Fund will certainly take up. He does not, however, expect this issue to delay the 5th Review.